Any other interpretation of the Act would totally eviscerate the intent of Congress to separate the local network company from the interLATA operations.

This reading does not mean that the interLATA affiliate may not provide a package of services that includes local exchange service. As discussed above, the interLATA affiliate simply must do so by obtaining local exchange service or unbundled network elements on the same basis that its competitors do. Of course, the FCC and State commissions still must be vigilant to ensure that the affiliate does not obtain service resale or unbundled elements on a preferential basis. 26/

It is critical that the FCC read the Act strictly to prohibit the telephone operating company from transferring any of its network facilities or capabilities to the interLATA affiliate, or from sharing such facilities or capabilities. There can be no exceptions to this rule. Application of Sections 201 and 202 to the affiliate would offer no protection. 27/ If they were, then Congress would have had no need to require the incumbent LEC operations that are subject to Section 251(c) to be separate from those of the interLATA affiliate. If the FCC were to allow exceptions, it would violate the plain language of Section 272, cause the entire statutory scheme to unravel, and make a mockery of the Commission's otherwise carefully constructed rules in this proceeding.

26/ The affiliate also may choose to deploy its own new network facilities. That said, regulators also must be sure that the operating company continues to meet its common carrier obligations to increase capacity to meet demand and improve its network services.

27/ See Notice at para. 71.

V. THE COMMISSION MUST CONTINUE TO CLASSIFY RBOC INTERLATA AND INTERNATIONAL SERVICES AS DOMINANT.

Notice at paras. 15-18, 115-152 [Sections I, VIII].

For the same reasons that strong structural separation provisions are required, the FCC also must retain dominant carrier classification for the RBOC's interLATA affiliates. In particular, dominant carrier status should apply during the initial period of RBOC interLATA activity. It remains to be seen whether newly-created rules and safeguards actually prevent discrimination. Undoubtedly adjustments will be necessary to address unanticipated market failures. In these circumstances, non-dominant regulation would be premature at the least.

In the Notice, the FCC relies in part on the Competitive Carrier definition of market power to analyze whether RBOC in-region interLATA offerings should be regulated as dominant. 28/ In its Competitive Carrier proceeding, the Commission defined market power for purposes of classifying carriers as "dominant" or "nondominant," with the goal of reducing or eliminating the level of tariff regulation for nondominant carriers. The Commission defined market power as "the ability to raise prices by restricting output" or as "the ability to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable." 29/

But in addition, the Commission concluded that market power arises from control of necessary inputs: "An important structural characteristic of the

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28/ Notice at paras. 16, 131-33.

29/ Notice at para. 114 and n. 26.

marketplace that confers market power upon a firm is the control of bottleneck facilities. * * * We treat control of bottleneck facilities as prime facie evidence of market power requiring detailed regulatory scrutiny." 30/

Under this definition, the RBOCs in their provision of interexchange access always have been classified as dominant. 31/ The question presented in this Notice is whether the FCC nevertheless should classify RBOC interLATA services as nondominant, since they will have no market share when they enter the market.

However, this focus does not adequately recognize the dangers of discrimination in the new world operated by the Act. The Commission must retain dominant carrier status for RBOC interexchange services even though they have no interLATA market share today. Serious dangers flow from the RBOCs' control over the local exchange network, and the inputs that are essential to its competitors --

30/ First Report and Order, Competitive Carrier Rulemaking, 85 FCC 2d 1, 21 (1980).

31/ The FCC has sought comment in another proceeding on whether to classify RBOCs' out-of-region interexchange activities as nondominant, and has, as an interim matter, permitted RBOCs to offer such services as nondominant carriers as long as they comply with certain safeguards. See Policy and Rules Concerning the Interstate, Interexchange Marketplace and Implementation of Section 254(g), Notice of Proposed Rulemaking, CC Docket No. 96-61, FCC 96-123, released March 25, 1996; Bell Operating Company Provision of Out-of Region Interstate, Interexchange Services, Report and Order, CC Docket No. 96-21, released July 1, 1996. We do not address this issue here, but note that LDDS WorldCom filed comments in CC Docket No. 96-21. There we did not oppose nondominant status for RBOC out-of-region activities, but only assuming strict separation of that affiliate. See LDDS WorldCom Reply Comments, CC Docket No. 96-21, (filed Mar. 25, 1996). However, the local bottleneck problem is obviously much different, and more serious, in the case of in-region service offerings.

both to originate and terminate interexchange calls, and to provide competing local exchange service. These risks dictate that dominant carrier regulation is necessary.

One risk is that the RBOC will take advantage of the fact that its competitors must pay what are concededly above-cost rates for access and price its affiliates' interLATA services below a level that its competitors profitably can match, thereby taking market share away from existing long distance carriers even though the RBOC's services and pricing -- but for its artificial cost advantage -- are no better than its competitors. 32/

As the Notice recognized, there are at least two ways that an RBOC can take advantage of this cost advantage, and both outcomes would dictate dominant classification. First, the RBOC can create a price squeeze for its competitors. "[T]he BOC affiliate could lower its retail price to reflect its unfair cost advantage, and competing providers would be forced either to match the price reduction and absorb profit margin reductions or maintain their retail prices at existing levels and accept reductions in their market shares." 33/ The FCC went on to point out that, "[a]lternatively, the BOC affiliate could simply match its competitors' prices and extract supracompetitive profits." 34/ With access costs making up approximately 40 percent of the total costs incurred by IXCs to provide interexchange service, such a cost advantage could be difficult to accommodate.

32/ See Notice at para. 14.

33/ Notice at para. 14.

34/ Notice at para. 14.

The second way that the RBOC could exploit its local network advantage would be to raise (or maintain above cost) access prices for all carriers, including its own interLATA affiliate. As the Notice recognized, under this scenario the RBOC nevertheless could capture market share simply by not raising its prices to reflect the increased access prices. 35/ "Although the affiliate would report little or no profit, the BOC firm as a whole would receive higher access revenues from unaffiliated interexchange carriers and increased revenues from the affiliate's interLATA services caused by its increased share of interLATA traffic." 36/

The structural separation, accounting, and imputation requirements in the Act do not successfully address the RBOCs' access cost advantage. 37/ First, even if the separate affiliate purchases access services on an arm's-length basis from the operating company, pursuant to tariff, 38/ and even if those access prices are imputed in the retail price of the affiliate's interLATA services, there is no way under price cap regulation to ensure that all the RBOC's other costs of providing the interLATA service are also reflected in those prices.

Second, there is an even more intractable problem with reliance upon imputation to address discrimination in a full-service world. Since the FCC

35/ Notice at para. 141.

36/ Notice at para. 141.

37/ See 47 U.S.C.§ 272(e)(3) (1996) (imputation requirement).

38/ This analysis does not even address the risks of discrimination by the operating company in favor of its interLATA affiliate in access pricing. Such discrimination can take place through such means as volume and term discounts or through offerings that are ostensibly generally available but in fact are usable only by the RBOC's interLATA affiliate.

regulates only one component of the packages -- interstate interexchange service -- an RBOC could effectively evade imputation requirements by passing on its access cost savings in reduced prices for the other components of the package -- local exchange and information services, for example. These services are not subject to the FCC's direct jurisdiction. As a practical matter, the FCC would have to regulate the retail rates for all components of the package to ensure that the RBOC was not evading the Act's proscription on discriminating in favor of its interLATA affiliate.

Equally important, all of the risks just discussed also apply to the necessary inputs that competitors require to provide local exchange service in competition with the RBOC. The RBOC has the same incentive and, despite the best efforts of this Commission and the state commissions, will have a great ability to use its control over essential inputs to local exchange service provision to favor itself over its competitors in the provision of packages of local exchange and interLATA service. 39/

Finally, as the FCC has recognized in this proceeding, price discrimination is by no means the only -- or even the most serious -- risk. "[D]iscriminatory preferences in the quality of the service or preferential dissemination of information provided by BOCs to their affiliates, as a practical matter, can have the same effect as charging unlawfully discriminatory prices." 40/ This holds true equally for exchange access and for the local service inputs -- resale or unbundled elements -- upon which the RBOCs' competitors depend.

39/ See discussion in Sections I and II, supra.

40/ Notice at para. 14.

This discussion leads to four conclusions:

First, the Commission must retain dominant carrier status for RBOC interLATA services, in order to enforce the imputation requirements and to ensure that the RBOC is not reducing its interLATA prices to levels that are impossible for its competitors to match. While dominant carrier regulation is not enough, it is certainly a necessary tool that the FCC must have to police its nondiscrimination requirements and the statutory imputation requirement.

Second, access for all interLATA providers must be priced at economic cost -- the effective price paid by the RBOC itself. 41/ This means that access must be brought down to economic cost before RBOC entry occurs, and that all subsidies must be removed from access rates. 42/ This task will be the subject of the FCC's access reform and universal service dockets.

Third, the FCC must adopt the structural separation approach discussed above -- in which the RBOC interLATA affiliate must obtain local exchange service inputs from the operating company on the same arm's length basis as its competitors if the RBOC chooses to offer full-service packages.

41/ See Interconnection Order at para. 679 ("We believe that our adoption of a forward-looking cost-based pricing methodology should facilitate competition . . . by establishing prices for interconnection and unbundled elements based on costs similar to those incured by the incumbents . . .") (emphasis added)

42/ Comments of LDDS WorldCom in Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, filed May 16, 1996, at 65-78; Reply Comments of LDDS WorldCom in Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, filed May 30, 1996, at 30-37.

Fourth, as we discuss in the next section, the FCC must be prepared to examine the profitability of the interLATA affiliate as compared with the profitability of the operating company. If the affiliate is significantly less profitable than the operating company, there may be some question as to whether the operating company is charging artificially high input prices to all carriers, including its affiliate, to the benefit of the corporation overall. 43/

VI. THE COMMISSION SHOULD MONITOR THE RELATIVE EARNINGS LEVELS OF THE OPERATING COMPANY AND THE INTERLATA AFFILIATE.

Notice at paras. 55-89, 94-107 [Sections IV, V, and VII].

The structural and nondiscrimination provisions of the statute, if properly implemented, will go far toward minimizing the ability of an RBOC to discriminate in favor of its affiliate in the pricing of exchange access or the inputs necessary to provide local exchange service. But the RBOC still could evade the nondiscrimination requirement by pricing all inputs -- whether to the affiliate or to competitors -- at levels above cost. 44/ The affiliate need not raise its prices to reflect these high charges. Even though the affiliate has paid too much for the input, and therefore reflects lower profitability, the company as a whole is better off because the excess charges paid by the affiliate are recovered by the operating

43/ See discussion in Notice at para. 141. This is a recommendation that is perhaps best addressed in the FCC's Accounting Safeguards proceeding. We expect to raise this proposal there, but observe that the record in this docket also points to the need for such monitoring. See Accounting Safeguards Under the Telecommunications Act of 1996, CC Docket No. 96-150, released July 18, 1996.

44/ See Notice at para. 141.

company. This "one pocket to the other" problem must be addressed if the FCC is to prevent discrimination in pricing by the RBOC in favor of its affiliate. 45/

A solution, for the time being, is for the FCC to require RBOCs to report to the FCC their earnings for each affiliate covered by Section 272 and for the operating company. Then it would be in a position to evaluate whether the RBOC is taking advantage of it ability to hide discriminatory pricing by moving its profit centers to the operating company. 46/

VII. THE RBOCS' INCENTIVE AND ABILITY TO DISCRIMINATE WILL NOT BE SUBSTANTIALLY DIMINISHED BY THE CONSTRUCTION OF NEW LOCAL NETWORKS.

Notice at paras. 5-9, 55-162 [Section I, IV, V, VI, VII, VIII].

The Commission cannot take heart from the possibility that increased local exchange competition will soon eliminate the need for structural and other protections against discriminatory pricing of exchange access and the inputs necessary for competitors to provide local exchange service. The Commission observed in the Notice that "[t]he emergence of efficient, facilities-based alternatives to the local exchange and exchange access services offered by the BOCs will, over time, eliminate the need for safeguards that Congress prescribed in the 1996 Act." 47/ This might turn out to be the case if there are several ubiquitous

45/ Price cap regulation, which is divorced from cost, is of little help in this case. Direct cost-based regulation of inputs is only somewhat more effective and applies only to some inputs at issue here.

46/ The FCC has ample authority to require reports on earnings of carriers subject to its jurisdiction. See also 47 U.S.C. § 272(d) (1996).

47/ Notice at para. 9. See also id. at para. 5 n. 16.

local exchange networks in a particular area -- such that those networks providers have an incentive to offer the use of their networks to competing carriers.

However, the Commission should not assume that a "second network" has an incentive to compete with the RBOC in the sale of network access, interconnection and inputs to local service. In the ordinary course a "second network" provider will be offering retail local and toll services to end users itself, and therefore will not necessarily have an incentive to make its network available to competing carriers on cost-based, non-discriminatory terms. For example, the "second carrier" in a duopoly situation may choose to sell access or network elements at the supracompetitive price level of the RBOC. 48/ Our point here is not to prejudge how the new post-Act market will develop. Our only intent is to caution against predicting when RBOC market power actually will decline.

For present purposes, it is enough that the Commission remain vigilant and observe the actual rate at which competitive networks are constructed and the effect of those additional networks on RBOC incentives. The mere introduction of new local exchange facilities -- and even of competing local exchange

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48/ The Maryland Commission, for example, has concluded that access competition does not eliminate the need for supervision of the rates and terms for access service provided to IXCs. See Application of MFS-Intelenet of Maryland, Inc. for Authority to Provide and Resell Local Exchange and Interexchange Telephone Service, Maryland Public Service Commission Case No. 8584, April 25, 1994 at 30 (MFS-I must fully support tariffs for terminating access because MFS-I "will be controlling bottleneck facilities that other carriers will need to access."); Investigation by the Commission on its Own Motion into Legal and Policy Matters Relevant to the Regulation of Firms Which May Provide Local Exchange and Exchange Access Services in Maryland in the Future, Maryland Public Service Commission Case No. 8587, October 5, 1994, at 46 (requiring new local service providers to provide equal access and presubscription to all interexchange carriers) networks -- will not be likely, at least in the near term, to substantially diminish an RBOC's ability to discriminate in pricing and provisioning of essential inputs to its competitors -- either exchange access or the elements needed to provide competing local exchange service. The Commission therefore must assume that the RBOCs' current ability and incentive to discriminate will continue for the foreseeable future. The need for structural and nondiscrimination safeguards, and dominant carrier status, will not be affected by the development of competitive local exchange network facilities in the next few years.

VIII. THE COMMISSION MUST ADOPT STRONG ENFORCEMENT PROCEDURES.

Notice at paras. 94-107 [Section VII].

It should go without saying that even the strongest of rules are meaningless without effective enforcement. LDDS WorldCom urges the Commission to adopt the strongest possible enforcement procedures and to devote the maximum resources to this effort. But we realize that even if the Commission were to increase by tenfold its enforcement resources, it would never be able to ensure that the RBOCs would not succeed in discriminating against their rivals. Structural measures such as those discussed earlier in these comments are the most effective and least resource-intensive tools -- and they have the virtue of preventing discrimination in advance. In contrast, enforcement measures can only have an impact after the fact once lasting damage to competition has been done.

That having been said, we urge the FCC to adopt strong enforcement procedures as a necessary element in its program to fully implement the pro-competitive promise of the Act. We agree with the FCC's tentative conclusion that the Section 271(c)(6) provisions generally augment the FCC's pre-existing enforcement authority. 49/

Specifically, we strongly support the FCC's proposal to shift the ultimate burden of proof from the complainant to the defendant in connection with Section 202(a) complaints, as well as complaints that the Section 271(d)(3) conditions are not met. 50/ If the RBOCs do not bear the ultimate burden of proof, they will simply make conclusory assertions, forcing complainants to make their own cases when the RBOCs possess the necessary facts. 51/ The short time frame required for the FCC to rule on complaints only exacerbates the problem, and makes discovery of the facts difficult if not impossible.

LDDS WorldCom also agrees that a prima facie case can be made by pleading that an RBOC has violated the Act, a Commission order or a regulation. This is the usual standard and there is no reason to make it more specific. LDDS WorldCom also supports the FCC's proposal not to presume that an RBOC's rates or

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49/ Notice at para. 97.

50/ Notice at para. 102.

51/ Ameritech adopted such an approach in its recent response to the Illinois Commission's Notice of Inquiry regarding Ameritech's Section 271 compliance. See Comments of Ameritech in Notice of Inquiry Concerning Illinois Bell Telephone Company's Compliance with Section 271(c) of the Telecommunications Act of 1996, Illinois Commerce Commission Docket No. 96-No I-1, filed July 31, 1996, at 2 ("Ameritech believes that it currently does comply with the requirements of Section 271(c), but it would be premature and fruitless at this point — before the implementing FCC rules have issued — to attempt conclusively to determine whether Ameritech Illinois complies with each and every aspect of that section as the FCC will interpret it.").

practices are lawful, regardless of its status as dominant or nondominant. 52/ We also agree that the FCC could determine that an RBOC has ceased to meet the conditions of its interLATA approval either on its own motion or via a Section 271(d)(6)(b) complaint. 53/ We cannot emphasize strongly enough, however, that no matter how strong the enforcement procedures, the conditions necessary prior to interLATA entry must be firmly in place before grant of an application, that structural separation must be implemented as discussed in these comments, and that dominant carrier regulation must be retained.

CONCLUSION

In order to promote competition in a post-MFJ world, the FCC must adopt strong structural separation and nondiscrimination rules, must retain dominant carrier classification for an RBOC's interLATA affiliate, and must adopt practical enforcement procedures. A key component of the structural rules must be the requirement that bundled "one-stop shopping" offerings of local and long distance service are provided only by the interLATA affiliate. This statutory

52/ Notice at para. 104. We urge the Commission not to classify the RBOC's interexchange affiliate's services as nondominant, as discussed above.

53/ Notice at para. 98.

requirement is central to Section 272, and necessary to give real meaning to the Act's separation and nondiscrimination protections.

Respectfully submitted,

WORLDCOM, INC. d/b/a LDDS WORLDCOM

By Kyle D. Dixon

Peter A. Rohrbach
Linda L. Oliver
Kyle D. Dixon
HOGAN & HARTSON L.L.P.
555 Thirteenth Street, N.W.
Washington, D.C. 20004
(202) 637-5600

Its Attorneys

Of Counsel

Catherine R. Sloan
Richard L. Fruchterman
Richard S. Whitt

WORLDCOM, INC.
d/b/a LDDS WorldCom
Suite 400
1120 Connecticut Avenue, N.W.
Washington, D.C. 20036

August 15, 1996